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BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2019-64-WS

Application of CUC, Inc. for Approval of an Increase in Rates and Charges and Modifications to Certain Terms and Conditions for the Provisions of Water and Sewer Service Provided to its Customers at Callawassie Island and Spring Island in Beaufort County, South Carolina	**REBUTTAL TESTIMONY OF GARY WALSH**

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND OCCUPATION.

A. My name is Gary Walsh. My business address is 1828 Bull Street, Columbia, SC 29201. I am employed as President of the Walsh Consulting Group LLC.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A. I received my Bachelor's Degree in Business Administration from the University of South Carolina in 1972. In July of 1972, I began my employment with the Public Service Commission of South Carolina ("Commission") in the Audit Department. During my 12 years in the Audit Department, I provided expert testimony in rate proceedings before the Commission. In July 1984, I was promoted to the position of Assistant Director of the Utilities Division. In that position I had direct supervision over the Electric, Telephone, Gas, and Water and Wastewater Departments. In July 1994 I was promoted to the position of Deputy Executive Director. In that position I had direct supervision over the Legal Department, Research Department, Utilities Department, and the Transportation Department. In July 1997 I was promoted to the position of Executive Director of the Commission. As the Executive Director I had supervision over approximately 80 employees, including Lawyers, CPAs, Ph.D.s, and Registered Engineers. I served in this position until my

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retirement November 1, 2003. In November 2003 following my retirement I formed the Walsh Consulting Group LLC, which provides lobbying and consulting services related to telecommunications, energy, and water and wastewater matters.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE COMMISSION?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to respond to issues addressed in testimony sponsored by ORS and specifically to the testimony filed by Michael L. Seaman-Huynh.

Q. DO YOU AGREE WITH ORS THAT A REFUND IS APPROPRIATE DUE TO THE TAX CUTS AND JOBS ACT (TCJA)?

A. No. CUC filed this case based on a twelve-month test year ending December 31, 2018. The TCJA took effect on January 1, 2018, and the reduced federal tax rates are incorporated in CUC's application in this docket. Therefore, even with the reduced federal tax rates being incorporated in this filing, CUC is earning substantially less than the 12.51% operating margin approved by the Commission in Order Number 2014-1001 dated December 2, 2014. In CUC's Exhibit D, included in this application, after accounting and pro forma adjustments, an operating margin of 4.03% is reflected. Even if the Commission accepted every adjustment proposed by the ORS, CUC would be earning an operating margin of 5.95% after accounting and pro forma adjustments, as reflected in Audit Exhibit KLM-1, substantially less than the 12.51% operating margin proposed by ORS. Both CUC and ORS agree that the Company is under-earning, so ORS's argument that the Company should refund "excess earnings" does not seem to be a reasonable recommendation since there are no excess earnings. The tax savings are fully reflected in the Company's Net Operating Income. The reduced tax rates do not give rise to a one-time windfall; they will be in place for the

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foreseeable future, permanently reducing the Company's revenue requirement. The customers are already benefitting from the reduced tax rates, and a refund serves no rational regulatory purpose. Also, the ORS's proposed refund of revenues would require the Commission to engage in impermissible retroactive ratemaking.

Q. PLEASE ADDRESS ANY OTHER CONCERNS WITH MR. SEAMAN-HUYNH'S TESTIMONY.

A. Beginning on Page 12 lines 5 through 18 Mr. Seaman-Huynh addresses ORS's treatment of what ORS calls "excess revenues" created by a reduction in the Federal Tax Rate included in the TCJA beginning January 1, 2018. ORS has proposed a calculation that would result in a total refund to CUC customers totaling $78,110, which it claims is "excess revenue" for the two year period January 1, 2018-January 1, 2020. ORS then amortized the $78,110 refund over a three-year period and included $26,037 as Adjustment 17 in Audit Exhibit KLM-1 to reflect Amortization of Excess Revenues. In making this calculation ORS utilized CUC's operating experience per a settlement agreement reached in Docket Number 2013-451-WS, which was based on a test year of December 31, 2013.

Even if the Commission orders a refund as a result of the TCJA, it should be based on the Company's <u>current</u> operating experience, instead of the Company's operating experience a full four years before the passage of the TCJA. The ORS used $963,072[1] in operating expenses based on a test year ending December 31, 2013 to calculate its refund, as shown in Exhibit MSH-4. As seen in Audit Exhibit KLM-1, which is based on the 12-month test year ending December 31, 2018, CUC's total operating expenses totaled $1,183,131. This substantial change in operating

1 Operating Expenses, $917,194 + Taxes other than Income, $44,538, + Interest Expense, $1,340 = $963,072.

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expense levels demonstrates the need to utilize the most recent audited financial statements in calculating the refund. The calculation of any savings resulting from the TCJA must be based on the Company's income and expenses in 2018 when the law was actually in effect.

Q. HAVE YOU CALCULATED CUC's TCJA SAVINGS USING CURRENT OPERATING EXPENSES?

A. Yes, using the operating experience proposed by ORS in Audit Exhibit KLM-1, I have calculated the annual refund due CUC customer to be $16,754 annually for the period January 1, 2018-January 1, 2020 the total refund due CUC customers under the TCJA would total $33,508. I have included Exhibit GW-1, which reflects the appropriate refund calculation should the Commission Order refunds. This is the same method that was employed to calculate the TCJA refund approved in Kiawah Island Utility, Inc.'s last rate case and approved by the Commission in Order No. 2019-288, Docket No. 2018-257-WS, and set out in a Memorandum of Understanding attached to the Direct Testimony of Donald H. Burkett as Exhibit DHB-1. I've attached a copy of the Memorandum of Understanding as Exhibit GW-2 to my testimony.

EXHIBIT GW-1
REFUND CALCULATION TCJA
TEST YEAR 12 MONTHS ENDED 12-31-18

	PRIOR TO TCJA	AFTER TCJA
Operating Revenues	1,284,946	1,284,946
Operating Expenses	1,183,131	1,83,131
Taxable Income	101,815	101,815
State Income Tax	5,091	5,091
Federal Income Tax	32,886	20,312
Net Income	63,838	76,412
Add Back Interest Expense	2,187	2,187
Net Income for Return	66,025	78,599
Cumulative Change		12,574
Retention Factor		75.05%
Annual Revenue Impact of Cumulative Change		16,754
Two Year Refund (1-1-18 / 1-1-20)		33,508

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Q. HOW COULD THE COMPANY MAKE REFUNDS TO ITS CUSTOMERS?

A. CUC could refund the entire $33,508 to its customers through a one-time bill credit.

Q. PLEASE EXPLAIN THE SECOND ISSUE OF CONCERN CONTAINED IN MR. SEAMAN-HUYNH'S TESTIMONY?

A. Yes, as I have stated, once Mr. Seaman-Huynh calculated the total customer refund of $78,110 as a result of the TCJA, and he amortized the refund over three years. He also included $26,037 in Audit Exhibit KLM-1 as an Amortization of Excess Revenues and added the amount to determine Net Operating Income. Adding the $26,037 as additional revenue overstates the operating margin, and artificially reduces the amount of additional revenue needed to achieve the operating margin reflected in Audit Exhibit KLM-1. Clearly, the inclusion of revenues that will be refunded to the customers in Net Operating Income does not establish sound regulatory policy. It also highlights the fallacy of refunding "excess revenues" in the first place, because these funds do not actually exist. In this proceeding, the Commission will be setting rates prospectively, and to base that decision on artificially inflated revenues would make it virtually impossible for the utility to achieve its authorized operating margin.

Q. HOW WILL CUC HANDLE THE INCOME TAX OBLIGATION FOR CONTRIBUTIONS IN AID OF CONSTRUCTION IN RESPONSE TO THE TCJA.

A. As noted in Michael Seaman-Huynh's testimony, the TCJA creates an income tax liability for CUC related to Contributions In Aid of Construction (CIAC). Commission Order No. 88-237 dated March 18, 1988 provides four different methods for a regulated utility to use to collect the income tax on CIAC. On a going-forward basis, CUC will utilize the full gross-up method to collect the income tax on CIAC.

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Q. WHAT WILL BE THE IMPACT OF THE ELECTION OF THE FULL GROSS-UP METHOD ON CUC?

A. Currently. CUC's approved water tap fee for a standard meter is $525 and the approved sewer tap fee is $625. On a going-forward basis, under the full gross-up method when a water tap fee is collected, a tap fee of $699.51 would need to be collected to account for the additional tax liability created by the TCJA. In the future when collecting a sewer tap fee, a tap fee of $832.75 would need to be collected to account for the tax liability created by the TCJA.

Q. ARE THERE OTHER FORMS OF CONTRIBUTION THAT ARE IMPACTED BY THE TCJA?

A. Yes, if CUC should receive a contribution in the form of property a similar calculation would be required based on the original cost of the property contributed.

Q. DO YOU AGREE WITH MR. SEAMAN-HUYHN'S RECOMMENDED OPERATING MARGIN OF 12.51%?

A. No, Mr. Seaman-Huynh's recommendation is unreasonably low in light of margins awarded to similarly situated utilities.

Q. HAVE YOU REVIEWED MR. SEAMAN-HUYNH'S SUMMARY OF OPERATING MARGINS RECENTLY AWARDED BY THE COMMISSION?

A. I have, and I believe it has several shortcomings. Mr. Seaman-Huynh does not consider any orders the Commission issued in 2019. The Commission's most recent orders in water and sewer cases would seem to be the most useful as a point of comparison with this case. Mr. Seaman-Huynh also appears to have omitted some orders when making his calculations. Also, the orders do not indicate a trend consistent with his recommendation of a 12.51% operating margin for CUC.

Q. WHAT WERE THE OPERATING MARGINS AWARDED BY THE COMMISSION IN 2019?

A. The Commission approved a 14.25% operating margin for Kiawah Island Utility, Inc. in Order 2019-288, and a 14.56% operating margin for Palmetto Wastewater Reclamation, Inc. in Order 2019-314. KIU's test year was January 1, 2017 to December 31, 2017 and Palmetto Wastewater Reclamation's test year was September 1, 2017 to August 31, 2018, more recent than the test year of the cases cited by Mr. Seaman-Huynh.

Q. DO YOU KNOW WHICH ORDERS MR. SEAMAN-HUYNH RELIED UPON FOR HIS CALCULATIONS?

A. Yes, ORS provided CUC a list of the orders. They were: Carolina Water Service, Inc. 2014-207, Palmetto Wastewater Reclamation, Inc. 2014-752, CUC, Inc. 2014-1001, Palmetto Utilities, Inc. 2015-153, Daufuskie Island Water Company 2015-846, Carolina Water Service, Inc. 2015-876, Harbor Island Utilities, Inc. 2017-80, Kiawah Island Utility, Inc. 2017-277(A), Palmetto Utilities, Inc. 2018-155, Synergy Utilities, Inc. 2018-369, Moore Sewer, Inc. 2018-445.

Q. IS THIS IS A COMPLETE LIST OF THE COMMISSION'S ORDERS IN WATER AND WASTEWATER CASES DURING THE YEARS 2014 TO 2018, THE TIME PERIOD HE COVERED?

A. No. I am aware of four other orders issued during this time period: Synergy Utilities, Inc. (*f.k.a.* Development Services, Inc.), 2015-460; T. J. Barnwell, Inc., 2016-49, Carolina Water Service 2018-345-(A), and Daufuskie Island Water Company, 2018-68.

Q. DO YOU HAVE A LIST OF ORDERS THE COMMISSION CAN LOOK TO FOR THE SAKE OF COMPARING OPERATING MARGINS?

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Yes, the list in Exhibit GW-3 below incorporates the orders referred to by Mr. Seaman-Huynh, the orders issued in 2019, and the additional orders identified above, with two exceptions. I have removed Order 2018-369, Synergy Utilities, Inc., and Order 2016-49, T.J. Barnwell, Inc.

Q. WHY DID YOU REMOVE ORDER 2018-369 AND ORDER 2016-49?

A. In these cases, the utilities received abnormally low operating margins. In Order 2018-369, Synergy was awarded a 10.32% operating margin, and in Order 2016-49, T.J. Barnwell was awarded a 4.55% operating margin. Both companies requested low operating margins to begin with. Synergy proposed an operating margin of 8.91%, lower than the 10.32% that was awarded. Order No. 2018-369. p. 16. T.J. Barnwell did not state a requested operating margin in its application, but it asked for a total increase in revenues of $42,636 (Application, p. 1) and received an increase of $43,385 (Order 2016-49, p. 15, Settlement Agreement Ex. 2) so a low operating margin was predetermined by the application.

Q. PLEASE EXPLAIN YOUR EXHIBIT GW-3

A. This exhibit sets out the orders issued by the Commission in water and wastewater cases from 2014 to date with approved operating margins except for the two orders I just mentioned. The orders listed in red are the ones I added to Mr. Seaman-Huynh's list. The exhibit shows the average operating margin was 14.56% from 2014 to 2019 and 14.30% from 2014-2019.

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EXHIBIT GW-3

COMMISSION APPROVED OPERATING MARGINS 2014-PRESENT

Company	Order Number	Operating Margin
CUC, Inc.	2014-1001	12.51%
Carolina Water Service, Inc.*	2014-207	12.69%
Palmetto Wastewater Reclamation, Inc.	2014-752	17.07%
Palmetto Utilities, Inc.	2015-153	17.98%
Synergy Utilities, Inc.	2015-460	15.00%
Daufuskie Island Water Company	2015-846	16.18%
Carolina Water Service, Inc.	2015-876	11.95%
Kiawah Island Utility, Inc.	2017-277(A)	14.00%
Harbor Island Utilities, Inc.	2017-80	13.75%
Palmetto Utilities, Inc.	2018-155	15.00%
Carolina Water Service	2018-345(A)	13.23%
Moore Sewer, Inc.	2018-445	14.99%
Daufuskie Island Water Company	2018-68	14.60%
Kiawah Island Utility, Inc.	2019-288	14.25%
Palmetto Wastewater Reclamation, Inc.	2019-314	14.56%
AVERAGE 2014-2019		**14.52%**
AVERAGE 2016-2019		**14.30%**

Q. DO THE LISTS OF COMPANIES RELIED ON BY MR. SEAMAN-HUYNH AND BY YOU IN EXHIBIT GW-3 INCLUDE COMPANIES THAT FILED APPLICATIONS BASED ON RATE OF RETURN METHOD OF RATE SETTING?

A. Yes, it does.

Q. WHAT HAPPENS IF RATE OR RETURN BASED ORDERS ARE ELIMINATED FROM THE LIST?

A. The average operating margins increase, as illustrated in Exhibit GW-4 below.

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EXHIBIT GW-4

COMMISSION APPROVED OPERATING MARGINS 2014-PRESENT

EXCLUDING RATE OF RETURN BASED APPLICATIONS

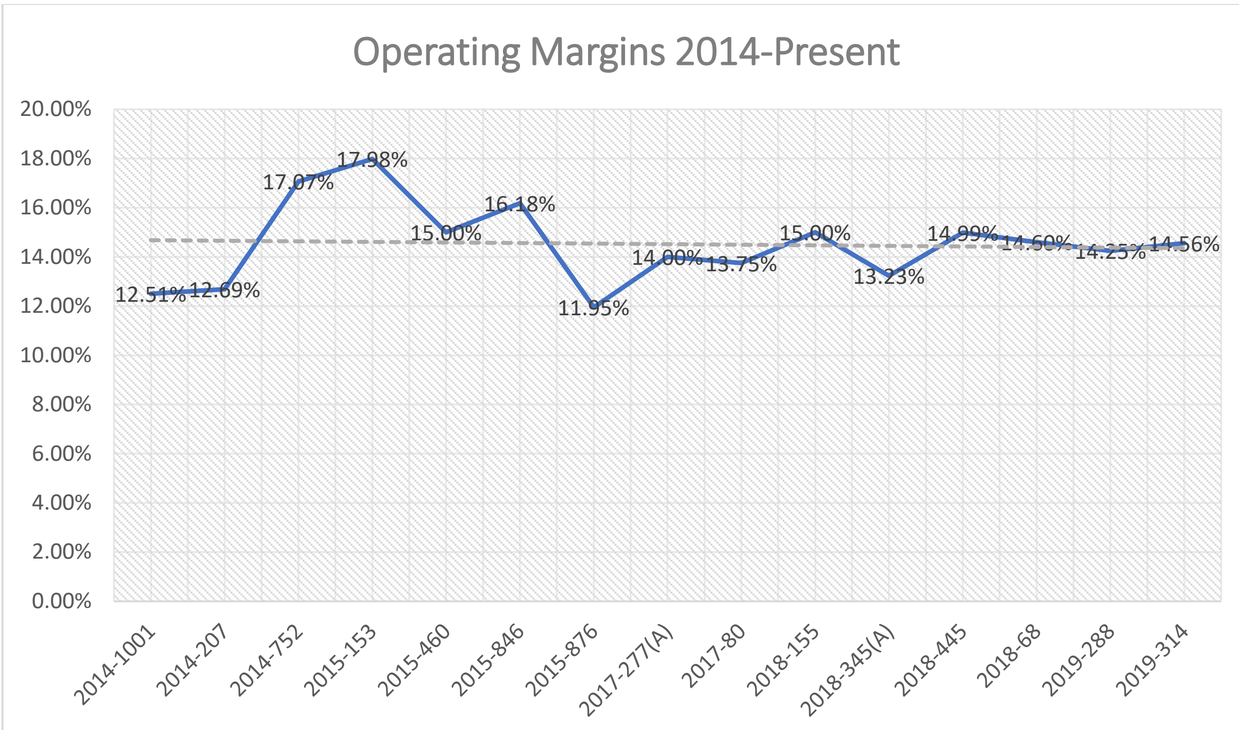
Company	Order Number	Operating Margin
CUC, Inc.	2014-1001	12.51%
Palmetto Wastewater Reclamation, Inc.	2014-752	17.07%
Palmetto Utilities, Inc.	2015-153	17.98%
Synergy Utilities, Inc.	2015-460	15.00%
Kiawah Island Utility, Inc.	2017-277(A)	14.00%
Harbor Island Utilities, Inc.	2017-80	13.75%
Palmetto Utilities, Inc.	2018-155	15.00%
Moore Sewer, Inc.	2018-445	14.99%
Kiawah Island Utility, Inc.	2019-288	14.25%
AVERAGE 2014-2019		**14.95%**
AVERAGE 2016-2019		**14.40%**

Q. DO YOU AGREE WITH MR. SEAMAN-HUYNH'S TESTIMONY THAT THE ORS'S RECOMMENDED OPERATING MARGIN OF 12.51% FOR CUC "REFLECTS RECENT TRENDS IN COMMISSION-ORDERED OPERATING MARGINS IN SOUTH CAROLINA"?

A. No, I do not. The graph below, Exhibit GW-5 illustrates the trends in the Commission's operating margins since it issued Order 2014-1001 in CUC's last rate case. The trend has remained well above the ORS' recommendation.

EXHIBITGW-5

OPERATING MARGINS TREND 2014-PRESENT



Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

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EXHIBIT GW-2

MEMORANDUM OF UNDERSTANDING

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BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2018-257-WS

Application of Kiawah Island Utility, Incorporated for Adjustment of Rates, Charges, Classifications and/or Regulations for Water and Sewer Services	**MEMORANDUM OF UNDERSTANDING**

Whereas, the Tax Cuts and Jobs Act of 2017 Pub. L. 115–97 ("TCJA") changed the tax laws affecting utilities providing water and wastewater services, and

Whereas, Kiawah Island Utility, Inc. ("KIU") is a duly certificated public utility providing water and wastewater service to customers in South Carolina, and

Whereas, KIU gave notice of its intent to apply for adjustment of its rates and charges on August 3, 2018 prompting the Public Service Commission ("PSC") to open Docket 2018-257-WS in anticipation of the company filing its Application, and

Whereas, the Office of Regulatory Staff ("ORS") is the agency charged with representing the public interest in matters before the PSC, and

Whereas, the ORS desires to ensure that certain benefits of the TCJA inure to the benefit of the ratepayers, including customers of KIU, and

Whereas, several questions about the accounting treatment for the TCJA remain unresolved in Docket No. 2017-381-A, pending before the Commission, and

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Whereas, KIU and ORS have reached a mutually acceptable understanding on how they desire to treat TCJA related issues in KIU's upcoming rate case, and

Whereas, KIU and ORS wish to memorialize their understanding and recommend its adoption to the Commission,

Now Therefore, KIU and ORS agree as follows:

1. Related to the revenues generated from the reduction in federal tax expense resulting from the change in the federal income tax rate from 34% to 21%:

   a. KIU agrees to defer the tax savings in an amount equal to the decrease in federal income tax expense from 34% to 21% in a regulatory liability from January 1, 2018 through the date of the expected Commission Order in the next rate proceeding.

   b. KIU and ORS agree the basis for the calculation of the regulatory liability is the test year period proposed by KIU in its expected Application (year ending 2017) as adjusted for pro forma adjustments.

   c. ORS will review and audit the test year expense and revenue calculations contained in the Application and make necessary adjustments during the ORS evaluation of the KIU Application for rate adjustment. The pro forma expenses and revenue used would reflect all adjustments ordered by the Commission prior to adjustment for the rate increase allowed.

   d. KIU and ORS will support the return of the tax savings booked to the regulatory liability to KIU customers by implementing a "Rate decrement", refund to customers as a credit on each monthly bill over a 36 month period.

2. Related to the Excess Deferred Income Tax re-valuation:

   KIU will include in its upcoming Application a re-valuation of the Accumulated Deferred Income Taxes to Excess Deferred Income Taxes based on the reduction in federal income tax rate and consistent with IRS normalization rules. Both of these accounts are considered in the treatment of KIU's rate base. Excess Deferred Income Taxes will be amortized as a reduction to operating expenses using the weighted average depreciable life of the associated fixed assets.

3. KIU will cease to actively participate in Docket 2017-381-A upon entering into this Memorandum of Understanding.

4. KIU and ORS acknowledge this memorandum results from a compromise of dispute issues. Nothing in this memorandum will preclude either KIU or the ORS from asserting legal positions regarding the effects TCJA or any other issue in other proceedings.

Signed and agreed to on the date(s) below:

FOR KIAWAH ISLAND UTILITY, INC.:

Date: 9/13, 2018

FOR THE OFFICE OF REGULATORY STAFF:

Date: 9/14, 2018

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